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Financial Rescues Show That Faith in Free Market Is Shaken

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Self-reliance. Individual responsibility. A faith in free markets and a belief that people should have the opportunity to fail or succeed on the basis of their hard work and ingenuity. These are qualities that have been as central to the national identity as they have been to the American economic model.

Which is why it is so extraordinary that the government now finds itself hip-deep in the direct management of the financial system, rescuing four of the country's biggest financial institutions -- Bear Stearns, Fannie Mae, Freddie Mac and now Lehman Brothers -- from the harsh discipline of markets and the consequences of their own misjudgments.

This unprecedented intrusion of government is coming in the waning days of the administration of a Republican president who made privatization, deregulation and a faith in free markets the centerpiece of his economic policies and of his political agenda.

But now, facing the very real risk of a global financial meltdown and the prospect that he could go down in economic history compared to Herbert Hoover rather than Ronald Reagan, the president and his appointees have decided to set aside their principles in favor of economic and political pragmatism.

It was only a decade ago, after the heads of some of Wall Street's biggest banks and investment houses were invited to a meeting at the Federal Reserve Bank of New York and merely encouraged to mount a private rescue for a failing hedge fund, that there were howls of protest from both the left and the right about undue interference. Although no public money was involved, nor any exercise of regulatory powers, the Fed's behind-the-scenes effort to prevent the collapse of Long-Term Capital Management was seen as an abandonment of free-market principles.

Today, those objections seem almost quaint.

In March, the Fed agreed to lend J.P. Morgan Chase $29 billion to finance the purchase of Bear Stearns at a price and on terms effectively dictated by the secretary of the Treasury. And to forestall the risk of other failures, the Fed for the first time opened its lending window to investment banks that were not normally subject to its regulatory oversight.

Then, last weekend, the government used its broad regulatory powers to force Fannie Mae and Freddie Mac to accept a federal takeover that could potentially require taxpayers to lend or invest hundreds of billions of dollars to prop up not only the two housing giants but also the depressed market for mortgage-backed securities.

Now, officials from the Fed and the Treasury are carefully orchestrating the breakup and sale of Lehman Brothers to rivals and investors. Although it is unclear whether any government money or guarantees will be involved, there is a chance that a part of the venerable Wall Street firm will wind up in the hands of a foreign bank.

If these actions had been taken in Moscow, Paris, Beijing or even Brasilia, they would have seemed merely confirmation of long-standing socialist instincts and traditions. But in Washington, they are revolutionary. As with the Great Depression, it has taken a full-blown financial crisis to shake the faith that free markets will always deliver better outcomes than politicians and bureaucrats.

It will be several years, and probably several more rescues and interventions, before the crisis has subsided. There is already talk of $25 billion to $50 billion in federal loans to the auto industry, along with an economic stimulus package chock full of "public investments."

And there is a consensus, even among Republicans, that financial deregulation went too far and that a new and more robust regulatory architecture will be needed.

But even after the economy has recovered and financial markets return to normal, a generation of Americans that has lived through the savings-and-loan crisis of the '80s, the Internet bubble of the '90s and the current credit crisis is likely to retain both a lingering suspicion of unregulated markets and a willingness to use the powers and resources of government to enhance economic stability.

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